

LBNL – PROCUREMENT STANDARD PRACTICES

Section: 49 Termination of Subcontracts

Subject: 49.2 Termination for Default

PURPOSE: This standard practice (SP) describes the Laboratory's policy and establishes procedures for the termination of subcontracts for default.

POLICY: The decision to terminate a subcontract for default is viewed as a serious matter. Delivery or performance is usually more desirable than the administrative burden of default procedures.

The Laboratory must be in a sound legal position to defend its termination action and should avoid situations in which a subcontractor may defend a termination with such defenses as defective specifications, improper rejection of goods, or untimeliness on the part of the Laboratory, etc.

SCOPE: This SP applies to all terminations for default except for subcontracts for commercial items. (See SP 2.1, *Definitions of Words and Terms -- General*, for definition of commercial item.)

DEFINITIONS:

Breach of Contract Breach of contract means a subcontractor has failed to meet mandatory contractual provisions (e.g., fails to meet item specifications or test specifications) or fails to make progress in prosecuting the subcontract work that endangers timely completion and fails to cure the defect within the time specified in a Cure Notice.

Cure Notice A Cure Notice is a written notice provided to the subcontractor of its failure to perform some of the provisions of the subcontract or to make satisfactory progress so as to endanger performance according to the items of the subcontract, which allows the subcontractor a specified period of time in which to correct (cure) its defective performance.

Forbearance Forbearance is the postponement of the decision to terminate for default while the Laboratory is investigating the reasons for the subcontractor's failure to meet contractual requirements. The Laboratory has a reasonable period of forbearance to investigate the facts and determine what course of action best serves its interests. Once the forbearance period expires, the Laboratory waives its right to terminate for default and must reestablish a delivery schedule if it wishes to reestablish an enforceable subcontract.

The forbearance period is not fixed; the facts and circumstances of each case determine the length of time constituting a reasonable forbearance period.

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Notice of Termination

Notice of Termination is the formal written termination of the subcontractor's right to proceed further under the subcontract.

Show Cause Letter

If the subcontractor fails to cure the defective performance within the time allowed by a prior Cure Notice, a Show Cause letter is issued. The Show Cause letter should request the subcontractor to defend the reasons why it should not be terminated for default (e.g., failures on the part of the Laboratory or an excusable delay).

Termination for Default

Termination for default is the exercise of the Laboratory's contractual right to completely or partially terminate a subcontract because of the subcontractor's actual or anticipated failure to perform its contractual obligations.

Excusable Delay Exception — Failure to perform may be determined to be excusable, if such failure arises out of causes beyond the control and without the fault or negligence of the subcontractor. If the reason for the subcontractor's delay is excusable, the subcontractor is entitled to an extension of delivery time rather than termination. Examples of excusable delays may be found in the appropriate *Termination for Default* clause in the Laboratory's standard terms and conditions.

Note: The excusable delay provision in construction subcontracts provides that the delays must arise from "unforeseeable causes." If the cause of the delay existed at the time of subcontract award and both parties were aware of its existence, it is not an "unforeseeable cause" and therefore is not excusable. For other types of subcontracts, it is considered immaterial whether or not a cause was in existence or known at the time of subcontract award and such awareness does not affect the excusability of a cause.

Waiver

Waiver is the intentional or voluntary relinquishment of a known right or conduct that warrants an inference that the right has been relinquished, even if such conduct is unintentional. For example, if within a reasonable period of time, the Laboratory fails to issue a termination for default based on late delivery of supplies and the subcontractor continues performance, the Laboratory has waived its right to terminate the subcontract for the subcontractor's failure to meet the delivery date.

PROCEDURES:

Applicability

The Laboratory may consider terminating a subcontract for default when a subcontractor:

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- Fails to perform the work under the subcontract within the time specified in the subcontract or any extension, including delinquent delivery;
- Fails to prosecute the work so as to endanger performance;
- Fails to perform any of the other material provisions of the subcontract;
- Is not in compliance with Equal Employment Opportunity (EEO) regulations (see SP 22.3, *Equal Employment Requirements*);
- Misrepresents or does not disclose that an organizational conflict of interest exists (see SP 9.3, *Organizational Conflicts of Interest*).

Burden of Proof

If the subcontractor can establish, or it is otherwise determined, that the subcontractor was not in default or that the failure to perform is excusable, i.e., arose out of causes beyond the control and without the fault or negligence of the subcontractor, the termination will be deemed to be a termination for convenience, with all the rights and obligations specified under the *Termination for Convenience* clause (see SP 49.1, *Termination for Convenience*). The Laboratory's evidence of a subcontractor's actual or anticipated failure to perform must be clear and convincing.

Coordination

Concurrence must be obtained from Laboratory Counsel (LC) and the Procurement Manager before the termination process is initiated. Close coordination with LC and the Manager must be maintained throughout the process.

Forbearance/ Failure to Perform

When a subcontractor fails to perform on or before the scheduled delivery date of a good or service, the Laboratory must, within a reasonable time, elect to terminate for default or to permit continuation of performance. The Laboratory is entitled to take sufficient time to determine what is in its best interest; at any time during this forbearance period, it may elect to terminate for default without waiving the original delivery schedule.

If the Laboratory fails to exercise its right to terminate for default within the forbearance period, the performance schedule must be revised through negotiation with the subcontractor in order to reestablish an enforceable subcontract. The subcontract must be modified to reflect the revised requirement.

Considerations for the Procurement Specialist

The following should be considered when determining whether to terminate for default:

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- The terms and conditions of the subcontract;
- The specific failure of the subcontractor and the excuses for the failure;
- The availability of the material or services from other sources;
- The urgency of the need for the material or services and the period of time required to procure them from other sources, compared with the time required for delivery by the delinquent subcontractor;
- The effect of the termination for default upon the subcontractor's capability as a supplier under other Laboratory or government subcontracts; and
- The extent to which the Laboratory's action or inaction may have led the subcontractor to believe its deficient performance has been excused.

Alternatives

The following courses of action are available in lieu of termination for default when it is in the Laboratory's or government's best interest:

- Permit the subcontractor to continue performance under a unilaterally revised delivery schedule imposed by the Laboratory if applied before or during the forbearance period. Negotiation of appropriate consideration must be attempted.
- Permit the subcontractor to continue performance by means of a subcontract with an acceptable third party, provided that the rights of the Laboratory and the government are adequately preserved.
- If performance has not begun and both parties agree, a no cost termination may be effected. A no-cost termination does not necessitate the formal submission of settlement proposals, etc.

Steps to be Taken

Cure Notice — Prior to subcontract expiration and upon determination that a subcontractor has failed to perform or failure is anticipated, a Cure Notice approved by the Procurement Manager, shall be sent to the subcontractor.

The Cure Notice:

- Gives the subcontractor a period of ten days (or more if authorized in writing by the Laboratory) after receipt of the Cure Notice to cure the failures;

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- Describes the nature and the extent of the defects which are to be corrected;
- Notifies the subcontractor that the subcontract may be terminated for default if the deficiencies are not cured within the specified time; and
- Refers to the specific clause authorizing the termination.

Note: If the Laboratory takes any action that the subcontractor might construe as a waiver of the subcontract delivery or performance date, a notice should be sent to the subcontractor setting a new date for the subcontractor to make delivery or complete performance. The notice shall reserve the Laboratory's rights under the subcontract's appropriate *Termination for Default* clause.

Show Cause — If the subcontractor fails to comply with the terms of the Cure Notice, the procurement specialist may, if deemed appropriate by LC and approved by the Procurement Manager, request the subcontractor to show cause why the subcontract should not be terminated for default. The subcontractor is given the opportunity to present, in writing, any facts bearing upon the issue. The Show Cause request may state that failure of the subcontractor to provide a defensible explanation may be taken as an admission that no valid explanation exists.

The procurement specialist is not legally required to elicit a Show Cause response from the subcontractor. Immediate action to terminate the subcontract may be taken by the procurement specialist after the period of time specified in the Cure Notice has expired.

Notice of Termination — If a subcontractor fails to cure the defects identified in the Cure Notice within the specified time and, if applicable, the subcontractor's Show Cause response does not provide a reasonable explanation and basis for its failure to perform, then the subcontract may be terminated for default by written notice to the subcontractor.

The Notice of Termination shall include:

- A statement that the subcontract is being terminated for default under the subcontract clause authorizing the termination for default;
- The effective date of the termination;

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- The extent of the termination (partial or whole);
- The acts or omissions constituting the default;
- A statement to the effect that the subcontractor's right to proceed further under the subcontract (or a specified portion of the subcontract) is terminated;
- A statement that the supplies and services terminated may be purchased against the subcontractor's account and that the subcontractor may be held liable for any excess procurement costs; and
- The steps the subcontractor should take to mitigate the impact on subcontractor personnel if the termination results in a significant reduction in the subcontractor's work force.

If the Termination Notice is received by the subcontractor subsequent to the date fixed for termination, then the effective date of termination is the date on which the Termination Notice is received.

The Cure Notice, Show Cause Letter, and Notice of Termination should each be sent to the subcontractor by certified mail, return receipt requested.

The Laboratory is not liable for a subcontractor's costs on undelivered work and is entitled to repayment of progress payments, if any, applicable to that work.

The Laboratory shall reimburse the subcontractor the subcontract price for any completed, delivered, and accepted work. The Laboratory may reimburse the subcontractor a negotiated price for any other property produced or acquired for the terminated portion of the subcontract which, as directed by the procurement specialist, is delivered and accepted by the Laboratory.

Effects

The Laboratory may withhold payment to the subcontractor to protect the Laboratory against loss from outstanding liens or claims of former lien holders.

The subcontractor shall be liable for the default of lower-tier subcontractors when the subcontracted goods or services are available from other sources in sufficient time for the subcontractor to perform the subcontract.

Subcontractor's Recourses

Under the *Disputes* clause contained in the subcontract, the subcontractor may appeal any or all of the following: the determination by the procurement specialist that the

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subcontractor's failure to perform is not excusable; the Laboratory's decision that the subcontractor is in default; or the amount of payment owed the terminated subcontractor. (See SP 33.2, *Disputes and Claims*.)

In some cases, such as the successful dispute of a termination for default, the Procurement and Property Management Department in conjunction with LC may reverse its original determination of termination for default if the subcontractor provides new and relevant information. In such an instance, the subcontractor's termination can then be deemed to be for the convenience of the University, with all the rights and obligations specified under the *Termination for Convenience* clause.

Cost Reimbursement Subcontracts

The settlement of a cost-reimbursement subcontract terminated for default is subject to the same principles as a subcontract terminated for convenience, except that:

- The cost of preparing the subcontractor's settlement proposal is not allowable and
- The subcontractor is reimbursed the allowable cost and an appropriate reduction is made in the total fee, if any.

(See SP 49.1, *Termination for Convenience*, sections titled "Subcontractor Obligations," "Disposal of Termination Inventory," and "Settlement Proposals" for additional requirements.)

Note: Because termination clauses in cost-reimbursement type subcontracts contain no provision for the collection of excess procurement costs (see below) from the subcontractor and because the defaulting subcontractor will receive payment of all of its incurred allowable costs, termination for default of cost-type subcontracts may not always impact the subcontractor adversely.

Excess Reprocurement Costs

The subcontractor is liable to the Laboratory for any excess costs incurred if repurchase is made at a price over the price of the supplies and services terminated.

Samples

See FAR 49.6 for samples of the Cure Notice, Show Cause Letter, Termination Notices, and Termination Settlement Agreements.

REVIEWS/ APPROVALS:

Laboratory Counsel (LC)

Concurrence from LC must be obtained before the termination process is initiated and close coordination must be maintained throughout the process.

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Procurement Manager

Concurrence from the Procurement Manager must be obtained before the termination process is initiated and close coordination must be maintained throughout the process.

Procurement Manager approval of the Cure Notice and Show Cause Letter must be obtained before issuance.

RESPONSIBILITIES:

Procurement Specialist

The procurement specialist must:

- Establish clear and convincing evidence of a subcontractor's actual or anticipated failure to perform;
- Obtain concurrence from LC and the Procurement Manager before the termination for default process is initiated;
- Maintain close coordination with LC and the Procurement Manager throughout the termination for default process;
- Decide, within a reasonable period of forbearance, whether to terminate for default or permit continuation of performance;
- Prepare the Cure Notice, approved by the Procurement Manager, and forward to the subcontractor in default;
- If the subcontractor fails to comply with the terms of the Cure Notice and if advisable, prepare the Show Cause letter, approved by the Procurement Manager, and forward to the subcontractor;
- If the subcontractor fails to show cause, prepare a Notice of Termination, approved by the Procurement Manager, and forward to the subcontractor; and
- Negotiate appropriate reimbursement for completed, delivered, and accepted work and/or property produced or acquired for the terminated portion of the subcontract.